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OGC 73-1315

17 July 1973

MEMORANDUM FOR: Deputy to the Director of Personnel

SUBJECT : Sick Pay Exclusion for Retirees --  
Federal Income Tax

1. In May and June two more federal court decisions held that a disability retiree is entitled to the sick pay exclusion until he reaches the mandatory retirement age and not, as Internal Revenue contends, only until he reaches the minimum age for voluntary retirement. Vance and Virginia Jovick v. United States, U.S. Court of Claims, No. 149-72, 6/20/73; Gene and Jule C. Reardon v. United States, U.S. District Court, Dist. of Colo. Civil Action No. C-3823, 5/30/73. As you know, [ ] retired from CIA for disability under the Civil Service Retirement System on 31 December 1959. The Court of Claims held that the Agency's age 60 retirement policy does not change the mandatory retirement age under the Civil Service Retirement Act, and that it can be assumed that [ ] might have been requested to remain in the service of the Agency after age 60 or been employed elsewhere in the government and continued in such employment until he attained the age of 70. STATINTL

2. We believe persons already retired under the Civil Service Retirement Act, as well as those being processed for retirement, should be aware of these and earlier decisions so that they may decide for themselves whether to claim the sick pay exclusion if they are between the earliest voluntary retirement age and the age of mandatory retirement. [ ]

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3. The IRS takes the position that persons retired for disability are entitled to the sick pay exclusion benefit under Internal Revenue Code section 105(d) only until they reach the age at which they could have retired voluntarily with no reduction in annuity. Several court decisions and Revenue Rulings have been issued on this point covering employees of the federal and local governments and of private industry. Revenue Ruling 68-385, 1968-2 CB53, provides specifically that the retirement age at which employees covered by the Civil Service Retirement Act are no longer entitled to claim the sick pay exclusion is age 55 with 30 years of service, age 60 with 20 years of service or age 62 with five years of service.

4. The Service's definition of retirement age and the pertinent Treasury Regulation section 1.79-2(b)(3)(i)(a)(1) and (2) have been held invalid several times in cases in Federal District Courts, the U.S. Tax Court and the U.S. Court of Claims, and two of these decisions have been affirmed by U.S. Courts of Appeal. W.L. Winter, (CA-3) 62-1 USTC Para. 9473, 303 F.2d 150; C.L. Brooks, (CA-6) 73-1 USTC Para. 9215, 473 F.2d 829. IRS has advised me that it still will not acquiesce and that it is preparing an appeal of the Reardon case to the U.S. Court of Appeals for the 10th Circuit. If IRS wins there, it will seek certiorari so that the Supreme Court can reconcile the conflicting circuit court decisions. If IRS loses again in the circuit, it will either acquiesce or request legislation to put into law the more restrictive rule which it has attempted to impose by regulation. The Reardon decision probably will be handed down in about a year.

5. At the present time, disability retirees living in the 3rd Circuit (Pennsylvania, New Jersey, Delaware and the Virgin Islands) and the 6th Circuit (Ohio, Michigan, Kentucky and Tennessee) are entitled to claim the sick pay exclusion until mandatory retirement age (age 70 under the Civil Service Retirement Act). Retirees living in the 10th Circuit (Colorado, Wyoming, Utah, New Mexico, Kansas and Oklahoma) will be entitled to the exclusion if the government loses the Reardon case on appeal.

Retirees living in the 10th and other Circuits than the 3rd and 6th may find it prudent to claim the exclusion and amend their returns as far back as the statute of limitations permits to preserve their rights in the event IRS finally loses or acquiesces in the contrary court decisions. Attached are copies of the most recent decisions and suggested language for notifying retirees and prospective retirees of the status of the law.

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Assistant General Counsel

Att.

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SUGGESTED LANGUAGE

The Internal Revenue Service holds that persons retired for disability under the Civil Service Retirement Act may claim the sick pay exclusion on their federal income tax return only until they reach the earliest age at which they could have retired voluntarily without a reduction of annuity. Such retirement age is age 55 through 59 with 30 years' service, age 60 or 61 with 20 years of service or age 62 through 70 with five years of service.

Several federal court decisions, including two decisions in U.S. Courts of Appeal, have invalidated the IRS position and held that a disability retiree may claim the sick pay exclusion until he reaches mandatory retirement age. This is age 70 under the Civil Service Retirement Act. Only the appellate decisions are binding precedents and, therefore, the more liberal rule will be applied only to taxpayers living in the states within the jurisdictions of those courts. The two binding appellate decisions are W. L. Winter, (CA-3) 62-1 USTC Para. 9473, 303 F.2d 150, and C. L. Brooks, (CA-6) 73-1 USTC Para. 9215, 473 F.2d 829. The Winter case is in the 3rd Circuit, covering Pennsylvania, New Jersey, Delaware and the Virgin Islands, and the Brooks' case is in the 6th Circuit covering Ohio, Michigan, Kentucky and Tennessee.

One of the two most recent decisions adverse to IRS has been appealed to the Court of Appeals for the 10th Circuit (Colorado, Wyoming, Utah, New Mexico, Kansas and Oklahoma) Gene and Jule C. Reardon v. United States, U.S. District Court, Dist. of Colo. Civil Action No. C-3823, 5/30/73. The decision in this case is not expected for about a year. If IRS loses, it may change its regulations to apply the more liberal rule or seek legislation to enforce the more restrictive rule. If IRS wins, it can be expected to appeal to the Supreme Court in order to reconcile the conflicting decisions of the lower courts.

Your decision on whether to claim the sick pay exclusion on current and future tax returns or to amend earlier returns is a personal one. Generally, the statute of limitations permits you to amend returns for three years after the due date. At the present time you may amend your returns for 1970, 1971 and 1972. Only those retirees living in states covered by the 3rd and 6th Circuits may expect their claims to be accepted by IRS if they are between the earliest normal retirement age and mandatory retirement age. Retirees living in other states whose claims are disallowed will have to litigate if they do not wish to accept the disallowance.

Persons retired under the Central Intelligence Agency Retirement and Disability System are not affected. Because early retirement requires the Director's permission, IRS does not consider it voluntary. Therefore, for purposes of the sick pay exclusion the mandatory and voluntary retirement age for GS-17 and below is 60 and for GS-18 and above is 65. The sick pay exclusion may be claimed until those ages.